IN THE HIGH COURT OF GUJARAT AT AHMEDABAD

INCOME TAX REFERENCE No. 342 of 1993

For Approval and Signature:

HON'BLE MR.JUSTICE D.A.MEHTA
HON'BLE MS.JUSTICE H.N.DEVANI

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1 Whether Reporters of Local Papers may be allowed to see the judgment ?

2 To be referred to the Reporter or not ?

3 Whether their Lordships wish to see the fair copy of the judgment ?

4 Whether this case involves a substantial question of law as to the interpretation of the constitution of India, 1950 or any order made thereunder ?

5 Whether it is to be circulated to the civil judge ?

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COMMISSIONER OF INCOME TAX - Applicant(s)

Versus

CALAMA PUMPS PVT LTD - Respondent(s)

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Appearance :
MR MANISH R BHATT for Petitioner No(s).: 1.

MR SN SOPARKAR for Respondent No(s).: 1.
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CORAM : HON'BLE MR.JUSTICE D.A.MEHTA
and
HON'BLE MS.JUSTICE H.N.DEVANI

Date : 02/08/2005

ORAL JUDGMENT

(Per : HON'BLE MR.JUSTICE D.A.MEHTA)

1.The following question of law has been referred by the Income Tax Appellate Tribunal, Ahmedabad Bench “B” under Section 18 of the Companies (Profits) Surtax Act, 1964 read with section 256(1) of the Income Tax Act, 1961 at the instance of the Commissioner of Income Tax.

> “Whether, the Appellate Tribunal is right in law and on facts in holding that the amount shown as balance of surplus of P & L A/c. on the first day of the accounting year should be treated as capital employed for computing the deduction under the S.T. Act?”

2.The assessment years are 1982-83 and 1983-84 with the respective accounting periods being years ended on 30th June 1982 and 30th June 1983. The dispute between the parties pertains to inclusion of a sum of Rs.11,93,448/- for assessment year 1982-83 and Rs.12,05,517/- for assessment year 1983-84 as part of capital employed for the purposes of computing statutory deduction under the Surtax Act. The

assessing officer, on perusal of the balance sheet, found that, on the first day of the accounting period, the aforementioned amounts were shown as balance of surplus of profit & loss account under the head “general reserve”. The contention of the assessee that the said sums were capital employed was turned down by the assessing officer.

3. The assessee carried the matter in appeal before Commissioner (Appeals), who vide his consolidated order dated 29-6-1987 held that the aforesaid sums had not been specifically transferred to the general reserve and could not be treated as capital employed as on the first day of the accounting year. The Commissioner (Appeals), after appreciating the decision in case of Vazir Sultan Tobacco Co. Ltd. v. Commissioner of Income, [1981] 132 ITR 559, has observed as under :

> “The conduct on the part of the Directors in setting apart this

> sum of reserve for treating the same as working capital clearly run counter to the argument that such surplus in the profit and loss account should be treated as part of the capital employed. When the Directors resolved to treat this surplus as working capital, it can be utilised for any purpose, in other words, it is not set apart or allocated for any specific purpose or occasion, only amount earmarked or set apart to be utilised for specific purpose and on specific occasion can be considered as reserve. The Directors resolution to treat it as working capital in fact run counter to their intention of treating it as part of capital."

4. The assessee carried the matter in second appeal before the Tribunal. The Tribunal vide its consolidated order dated 31st July 1992 upheld the contention of the assessee and held that the sums were liable to be included as reserve in light of the ratio of decision rendered by the Calcutta High Court in case of Dunlop India Ltd. v. CIT (Calcutta), 141 ITR 542. After reproducing relevant extract from the High Court decision in paragraph No.13 of

the impugned order, the Tribunal has observed that, “the principles laid down by the Hon'ble High Court is applicable in this case also.”.

5. It is necessary to take note of the fact that, in the case before the Calcutta High Court, a specific finding of fact was recorded that the Directors in the Report presenting the Statement of Accounts had stated that the surplus standing on the last day of the preceding year had been decided to be merged with the “general reserve” with effect from the first day of the accounting year. In the present case, the Tribunal has, in paragraph No.15, referred to the submission on behalf of the assessee and recorded that “subsequently, by resolution of Board of Directors, the amount disputed was actually treated as reserve.”.

6. As to when does a particular sum become a reserve is no longer *res integra*. The Apex Court in the case of Vazir Sultan Tobacco Co. Ltd. v. Commissioner of Income (supra) has laid

down the principles as under:

> “The question whether the concerned amounts constitute “reserves” or not will have to be decided by having regard to the true nature and character of the sums so appropriated depending on the surrounding circumstances particularly the intention with which and the purpose for which such appropriations had been made.
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> The true nature and character of the appropriation must be determined with reference to the substance of the matter: this means that one must have regard to the intention with which and the purpose for which the appropriation has been made, such intention and purpose being gathered from the surrounding circumstances. The following aspects provide some guidelines: (a) a mass of undistributed profits cannot automatically become a reserve and somebody possessing the requisite authority must clearly indicate that a portion thereof has been earmarked or separated from the general mass of profits with a view to constituting it either a general reserve or a specific reserve, (b) the surrounding circumstances should make it apparent that the amount so earmarked or set apart is in fact a reserve to be utilised in future for a specific

> purpose and on a specific occasion, and © a clear conduct on the part of the directors in setting apart a sum from out of the mass of undistributed profits avowedly for the purpose of distribution as dividend in the same year would run counter to any intention of making that amount a reserve.”

6.As already noted hereinbefore, on the one hand, the Commissioner (Appeals) has found that the Directors resolved to treat the surplus as working capital, while on the other hand, the Tribunal refers to a subsequent resolution of the Board of Directors to treat the disputed amount as reserve. Neither of the resolutions, referred to by the Commissioner (Appeals) and the Tribunal, are available on record. It is not possible to state as to what the resolutions convey, when were the resolutions passed, as to whether the resolutions were approved by the General Body or not, and most importantly, the resolutions were pertaining to which period, namely the accounting years under

consideration or not. In absence of these basic facts, it is not possible to answer the question referred.

7. Accordingly, the question is left unanswered. The Tribunal shall apply the settled legal position after finding facts on record and giving an opportunity of hearing as well as placing additional evidence on record, if necessary.

8. The Reference stands disposed of accordingly. There shall be no order as to costs.

[D.A.MEHTA, J.]

[HARSHA DEVANI, J.]

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